United States Court of Appeals

for the Second Circuit

APPELLEE'S BRIEF

74-2326

To be argued by
HAROLD P. WEINBERGER

In The

United States Court of Appeals

For The Second Circuit

In the Matter of

D.H. OVERMYER CO., INC. (MINNESOTA), et al.,

Debtors-Appellants,

and

ROBERT P. HERZOG,

Receiver-Appellant.

BRIEF OF APPELLEE, THE 614 COMPANY

NICKERSON, KRAMER, LOWENSTEIN,
NESSEN, KAMIN & SOLL
Attorneys for Appellee The
614 Company
919 Third Avenue
New York, New York 10022
(212) 688-1100

HAROLD P. WEINBERGER
Of Counsel

(7715) LUTZ APPELLATE PRINTERS, INC.
Law and Financial Printing
South River, N. J. (201) 257-6850 New York, N. Y. (212) 565-6877 Philadelphia, Pa. (215) 563-5587 Washington, D. C. (202) 783-7288

TABLE OF CONTENTS

TABLE OF AUTHORITIES*

Cases

---

* This table of authorities incorporates the authorities cited in the brief submitted by The 614 Company to the district court, which by this Court's order is to be considered the main brief on this appeal. Page references to that district court brief are preceded by the letters "D.C."

Other Authorities

leases to the landlords.

On October 15, 1974 this Court denied applications by Overmyer and the Receiver for a stay of the district court's order pending appeal. At the same time, the Court ordered that this appeal be heard on an expedited basis, and that the appeal be heard on the briefs filed in the district court plus supplemental typewritten briefs on the opinion of the court below. So that the intent of this Court's order expediting this appeal can be effected, we have attached 614's brief submitted to the district court (the "district court brief") as Appendix A. We deal here only with issues raised by Overmyer and the Receiver in connection with Judge Werker's opinion.

The Issue Presented

Did the district court properly find that the bankruptcy judge did not abuse his discretion by declining to exercise his equitable powers to nullify a valid bankruptcy termination clause?

Statement of the Case

The facts

The facts and procedural history of this case are fully detailed in the district court brief (D.C. 1-18)*. Because of issues raised anew by Overmyer and the Receiver, we merely highlight two points here.

First, in terminating its lease with Overmyer for Minneapolis #4, 614 relied not on rent defaults but rather on an express bankruptcy termination clause (D.C. 4-5). Thus, Point I of the Receiver's brief has no application to 614.

Secondly, 614 showed at trial that a history of late payments by Overmyer prior to its institution of the Chapter XI proceeding resulted in numerous legal proceedings by 614; legal fees and interest resulting from those late payments are, under the lease, "additional rent" and constitute pre-petition arrears on Minneapolis #4 which have not been tendered. (D.C. 10-11). The significance of this

---

* Numbers preceded by the letters "D.C." are citations to pages in 614's district court brief, which immediately follows this brief.

fact will become clear in the context of the Receiver's argument that the district judge made improper findings regarding Overmyer's pre-petition conduct.

Both of these facts show why Minneapolis #4 is nowhere singled out for extended discussion in the briefs filed in this Court by Overmyer and the Receiver.

The proceedings in the district court

Overmyer and the Receiver pressed several contentions in the district court. They argued that Judge Babitt should have been required to make separate findings of fact in each and every proceeding and that the findings of fact in his opinion -- and implicitly his conclusion that the issue presented was in essence an issue of law -- were incorrect. They argued that Judge Babitt incorrectly found that the plan of arrangement was not a feasible one despite the fact that Judge Babitt, as the bankruptcy judge, has the ultimate responsibility for confirmation of the plan. Finally they contended that despite Judge Babitt's careful analysis of factors this Court required be considered for a lease termination in a Chapter XI proceeding, his

finding that the equities of this case rested not with Overmyer but with 614 was error. In short, as we characterized their argument to the district court, they contended that Judge Babitt had abused his discretion by enforcing valid bankruptcy termination clauses in the circumstances of this case.

The district court rejected each of these contentions. In a lengthy opinion, Judge Werker found that specific findings for each litigated property were unnecessary:

> "The essential findings with respect to the leases terminated by the landlords * * * are contained in Judge Babitt's memorandum decision at pages 9, 10 and 11. These findings are sufficient under Bankruptcy Rule 752 for they afford a clear understanding of the grounds on which the bankruptcy judge based his decision." (Footnote omitted). (21a-22a)*

Furthermore, the district court, after analyzing the proposed plan of arrangement and reviewing the findings of Judge Babitt, agreed that the plan was unfeasible, in

---

* Numbers followed by the letter "a" are citations to pages in the Receiver's Appendix. The trial transcripts in the Appendix are numbered with a lettered prefix corresponding to the first letter of the warehouse location; thus references to 614's trial transcript will be, for example, "M1-a".

part because of its rejection by the creditor committees and also because it contained "no explanation * * * as to how these payments are to be financed." (18a-19a).

Finally, the district court carefully analyzed the equitable factors which this Court had previously held might in some cases justify non-termination of a lease. In addition to the factors considered by Judge Babitt in his opinion, discussed in detail in the district court brief (D.C. 15-18), the court below carefully reviewed the transcripts of the trials held before Judge Babitt and found that Overmyer's pre-petition conduct with respect to these landlords further militated against its right to invoke the powers of a court of equity.

The district court was "convinced that there was no clear error by the Bankruptcy Judge with respect to the facts." (22a). The court below was "persuaded that upon those findings the question which Judge Babitt was required to decide was one of law, i.e., whether upon the facts of this case and prior decisions in this Circuit he should exercise his discretion in equity to set aside the termination of the leases * * *." (22a). Finally, the court below

held that Judge Babitt not only did not abuse but indeed properly exercised his equitable discretionary authority:

> "The evidence * * * demonstrates a course of conduct on the part of Overmyer which warrants the exercise of discretion in the landlords rather than appellants' favor. This is especially so in light of the proposed plan of reorganization which simply cannot be characterized as feasible. It is the conclusion of this Court, therefore, that there was no abuse of discretion on the part of the Bankruptcy Judge in failing to exercise his discretion in favor of the appellants. It is also this Court's conclusion that Overmyer, because of the nature of its business operations, and its failure to meet its several obligations, simply cannot be rehabilitated." (Footnote omitted) (23a-24a).

The contentions on this appeal

As applied to 614, Overmyer and the Receiver raise three contentions on this appeal.

First, they argue again that Judge Babitt incorrectly failed to make specific findings of fact with respect to each case. That argument we have discussed in the district court brief (D.C. 15-16). In light of the district court's clear findings on this point, in light of its ability as an appellate court adequately to review Judge Babitt's opinion, and in light of the failure of the Receiver and Overmyer to cite in their briefs a single additional

case in support of their contention, their argument has even less merit here than it had below. Moreover, whatever merit that argument might have with respect to other landlords -- and we believe it has none -- it clearly is irrelevant to 614 which, because it relied on the bankruptcy termination clause in its lease and because it is owed pre-petition arrears, comes squarely within the findings made in Judge Babitt's opinion. We therefore will make no additional argument on this point.

Second, Overmyer and the Receiver contend, as they did below, that the district court's finding that the plan was not a feasible one was error. In addition, they contend that the district judge, by reviewing the trial transcripts and reaching the inescapable conclusion that Overmyer, prior to the filing of the petition, evidenced a pattern of conduct which barred it from seeking equitable relief, somehow departed from the proper standards announced by this Court.

The Receiver makes much of the "significance of this appeal in terms of equity and bankruptcy jurisprudence * * *." (Brief of Receiver at 2). That characteriza-

tion could only result from a fundamental misconception of the issues raised by Overmyer and the Receiver. In essence they contend on this appeal as they did below not that the district court refused to weigh the equities but that the balance it reached -- the conclusion that the equities were not in Overmyer's favor -- was wrong. Even were that conclusion, reached also by Judge Babitt, a marginal one, the appropriate standard of review would require an affirmance by this Court. Here, however, the conclusion of both courts is amply supported by the record.

We show in this brief as we did below, that the refusal of Judge Babitt to exercise his equitable powers and the holding of the court below that this refusal was a proper exercise of discretion is fully consistent with -- and indeed mandated by -- the law of this Circuit.

Argument

THE DISTRICT COURT PROPERLY FOUND THAT THE BANKRUPTCY JUDGE DID NOT ABUSE HIS DISCRETION BY DECLINING TO EXERCISE HIS EQUITABLE POWERS TO NULLIFY A VALID BANKRUPTCY TERMINATION CLAUSE

The district court correctly held that the bank-

ruptcy judge -- by declining to nullify a valid termination clause -- did not abuse his discretion. Quite the contrary, the district court's findings serve to strengthen the conclusion that Judge Babitt properly analyzed the tests laid down by this Court and quite properly declined in the circumstances to exercise what concededly was merely a discretionary power.

This Court's opinion in Queens Boulevard Wine & Liquor Corp. v. Blum, F.2d Docket No. 73-1512 (2d Cir. June 11, 1974), discussed in full in the district court brief (D.C. 22-25), stands for the proposition that although bankruptcy termination clauses are clearly enforceable, "compelling equitable and policy considerations" may justify the exercise by bankruptcy courts of equitable powers to, in effect, nullify those clauses. (Slip op. at 4120). But Queens Boulevard does not mean that mere profitability of a lease, coupled with the filing by the tenant of a Chapter XI proceeding, in and of itself requires a court to ignore a bankruptcy termination clause. As the district court aptly noted, "the Queens Boulevard decision was an exception to the general rule of enforceability of

bankruptcy forfeiture clauses." (19a). Queens Boulevard envisions that a court examine certain factors to determine where the equities lie, and based upon those factors, that it determine whether or not an exception to the general rule of enforcement should be carved out.

It was just such a determination, made by Judge Babitt in 614's favor, that the district court reviewed. Its opinion thoroughly analyzed the factors which Judge Babitt, in turn, had found determinative. None of those factors -- save the questions of feasibility of the plan and the pre-petition conduct of Overmyer -- are the subject of any serious challenge on this appeal.

Our district court brief reviews in detail the criteria established in Queens Boulevard and the application of those criteria to the facts of this case. (D.C. 22-27). Isolating one factor or another, as Overmyer and the Receiver have done here, leads to the misleading conclusion that each one is a separable issue. Clearly they are not; they are merely components which, when added together, lead to a conclusion on the equities. But even on their own terms, the "issues" raised by Overmyer and the

Receiver are spurious ones.

The district court's finding that the plan is not a feasible one is the result of a two-pronged analysis. First, the court below relied on the findings made by Judge Babitt who, as the bankruptcy judge, has the ultimate authority for confirmation of the plan. Bankruptcy Act § 361-66, 11 U.S.C. §§ 761-66 (1964). In addition, the district court examined for itself the proposed plan of arrangement and, from the standpoint of an appellate court, confirmed the conclusion of the bankruptcy judge.

The plan of arrangement divides landlord creditors -- by far the predominant class of creditors -- into two classes. Those landlords whose property Overmyer wishes to retain are supposedly to be paid 100% of all pre-petition arrears, despite the fact that throughout the Chapter XI proceedings the Receiver could not even make timely use and occupancy payments. Those landlords whose leases were rejected -- many of whom, including 614, are the same landlords with litigated properties -- are to be paid their pre-petition arrears by non-interest payments of 1% of the debt every two months, or 6% per year, which means

they are to be paid out in 16 years and 8 months. With those figures, it becomes easy to see how two courts and the various creditors' committees have reached their conclusions.

In any event the finding of non-feasibility by the court below was clearly supported by the record, particularly in light of the total absence of any proof to the contrary by Overmyer and the Receiver. Queens Boulevard stands in marked contrast. That the plan in Queens Boulevard was feasible was obvious by totally objective criteria, for it had been accepted by the creditors and was on the verge of confirmation. Only the landlord's petition to regain possession of the debtor's sole place of business stood in the way. Clearly that is not the case here.

The challenge by Overmyer and the Receiver to the district court's finding regarding the pre-petition conduct of Overmyer evidences a more serious misconception about the holding of Queens Boulevard. In the first place, that finding -- made by the district judge after a review of thousands of pages of trial transcripts -- is clearly a

correct one. The transcript of the trial of 614's petition, for example, reveals evidence of a continuous pattern of late payments requiring repeated state court litigation. (M7a-M16a). Other transcripts, discussed by the district court in its opinion, reveal other serious and extensive hinderances by Overmyer. (15a-16a). Clearly, the finding of the court below is amply supported by the record.

More significantly, however, the emphasis placed on this point results in a failure to place it in proper context. The Receiver's brief pretends that this finding was the sole basis of the district court's opinion -- despite the fact that Judge Babitt did not expressly rely on it and the district court found Judge Babitt's analysis of the equitable considerations to be correct. All of the other factors Judge Babitt considered -- including the crucial point that unlike the landlord in Queens Boulevard which had suffered "no harm whatsoever" (slip op. at 4123), 614 and others have indeed been prejudiced -- are components of the district court's affirmance.

Since it is clearly supported, the district court's finding regarding Overmyer's pre-petition conduct serves

to buttress the conclusion that the equities simply do not favor Overmyer. But even were that finding incorrect -- even had Overmyer conducted its business in an above-board manner prior to the filing of its petition -- the conclusion reached by Judge Babitt without that factor, and affirmed by the court below, would be precisely the same.

Two courts have reviewed the equities here and found that those in favor of Overmyer are not only not compelling but are virtually non-existent. Only a contention -- rejected by both courts -- that mere profitability of a lease, with nothing more, requires termination under a "windfall" theory could overcome the conclusion that fact requires. That is clearly not the law of this or any other Circuit. Except in circumstances where "compelling equitable and policy considerations" dictate otherwise -- considerations within the province of the equitable discretion of the bankruptcy judge in the first instance -- termination clauses agreed to by commercially knowledgeable parties should be enforced. In finding that those compelling considerations did not exist here Judge Babitt, as we detailed in our district court brief, clearly acted well within the

limits of his equitable discretionary authority. In finding that Judge Babitt did not abuse his discretion the district court, too, was clearly correct and should be affirmed.

Conclusion

For all of the foregoing reasons and for the reasons stated in the attached brief submitted to the United States District Court for the Southern District of New York, appellee The 614 Company respectfully requests that the order appealed from be affirmed.

New York, N.Y.
November 11, 1974

Nickerson, Kramer, Lowenstein,
Nessen, Kamin & Soll
Attorneys for Appellee The 614 Company
919 Third Avenue
New York, New York 10022
(212) 688-1100

Harold P. Weinberger
Of Counsel

APPENDIX A - DISTRICT COURT BRIEF

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

In the Matter	:	
of	:	
		73 B 1144
D. H. OVERMYER CO., INC. (MINNESOTA),	:	
Debtor.	:	

BRIEF OF PETITIONER-APPELLEE
THE 614 COMPANY

Preliminary Statement

Appellants D. H. Overmyer Co., Inc. ("Overmyer")* the debtor in proceedings for an arrangement under Chapter XI of the Bankruptcy Act, and Robert P. Herzog, Receiver for the debtor (the "receiver") appeal from an order of Hon. Roy Babitt, Bankruptcy Judge, granting petitioner-

* D. H. Overmyer Co. Inc. of Ohio and 38 of its subsidiaries are debtors in Chapter XI proceedings filed in this Court. The subsidiary which technically has appealed the order and judgment here is D. H. Overmyer Co., Inc. (Minnesota).

appellee, The 614 Company ("614") a declaratory judgment terminating a lease between Overmyer, as tenant, and 614, as landlord, as of December 27, 1973, and granting to 614 possession of the leased premises as of July 31, 1974.

Judge Babitt's order and judgment followed a lengthy and well-reasoned opinion which also granted similar relief with respect to 20 other properties leased by various landlords to Overmyer.

The Issue Presented

In finding that no circumstances exist here to justify nullification of a termination duly effected under an unqualified lease provision making the filing of a Chapter XI proceeding a default which may not be cured, did the court below properly exercise its equitable discretion?

Statement of the Case

This appeal concerns the effect to be given certain unequivocal provisions of a lease between the parties. Judge Babitt held, and we urge on this appeal, that those provisions -- under the circumstances of this case inter-

preted in light of the law of this Circuit -- should be enforced by their terms.

The lease

614 is the owner of a building known as Minneapolis #4, containing approximately 120,000 square feet of warehouse space at 5300 West 76th Edina, Minnesota (the "premises"). In January 1969, 614, as landlord, executed a lease with Overmyer, as tenant, for the premises for a period of 20 years. The lease provided for payment of rental in the amount of $7,698.25 per month for a 20-year term and a somewhat lower rental for two 10-year option periods following the expiration of the term.

The principal business of the Overmyer operation as a whole -- very briefly stated -- was the rental of warehouses from landlords such as 614 and the reletting of such warehouses to one or more subtenants, usually for shorter periods of time and for an amount in excess of that payable under the leases with the various landlords. Thus here, as elsewhere, Overmyer did not occupy the premises itself, but rather subleased the premises, collected rent from the subtenants and paid to 614 the stipulated rental.

The lease between the parties here was a net lease. Except for the mortgage,* all payments and obligations, including taxes, maintenance, repairs, insurance and otherwise, were the responsibility of Overmyer.

The provisions involved on this appeal are contained in sections 15.01 and 15.02 of the lease (Exhibit A to the Petition of The 614 Company). Section 15.01 provides that the filing of a petition under Chapter XI of the Bankruptcy Act shall be an "event of default". Pursuant to section 15.02, the landlord, 614, is permitted if an "event of default" occurs, to terminate the lease "thirty (30) days after the giving of * * * notice" of such default. On that date "all right, title and interest of Tenant hereunder and all those persons under it shall thereupon expire as fully and completely as if the date specified in such notice were the date specifically fixed herein for the expiration of the term of this Lease * * *." In short, the

---

* The lease provides in section 3.06 that 614 shall pay the interest and amortization due on a mortgage on the premises. That section expressly contemplates, however, that "* * * the rental payments * * * are in part composed of * * *" such mortgage payments, thus recognizing that 614 was to make them out of rentals paid to it by Overmyer.

lease contains an express and unqualified bankruptcy termination clause. No other clause limiting those sections or bearing upon them in any way exists in the lease.

The proceedings below

On November 16, 1973 Overmyer filed its proceeding for an arrangement under Chapter XI of the Bankruptcy Act. Shortly thereafter, on November 27, 1973, 614 notified Overmyer, by letter sent to Mr. E. M. Connery, its Vice President, giving notice "pursuant to Section 15.02 of said lease that said lease shall be and hereby is terminated effective December 27, 1973." (Exhibit B to the Petition of The 614 Company). Although there were prepetition arrears, about which more will be said later, the termination letter was predicated solely on the bankruptcy termination clause.

On December 6, 1973, 614 served a petition, by order to show cause, seeking a declaration that, pursuant to this notice duly given, the lease would be terminated as of December 27, 1973. In addition, 614 requested that the Court grant possession of the premises to it on that date or in the alternative, that the Court vacate a previously

entered stay which prevented 614 from regaining possession of the premises in the appropriate state court. The answers of the receiver and Overmyer, filed on January 8, 1974, alleged that Overmyer was realizing a profit from the operation of the premises, that termination would "unjustly enrich" 614, and that termination would prevent Overmyer from proposing a reasonable plan of arrangement. In addition, the answers denied that a valid termination of the lease had been made.

Trial of 614's petition was held on January 23, 1974. At the outset, counsel for the receiver stipulated to the existence of the lease, the occurrence of an act of bankruptcy and the sending of a 30-day bankruptcy notice of termination by 614 on November 27, 1973. (Transcript p. 4).* Consequently that portion of the answers which had claimed a failure to make a valid termination was withdrawn on 614's motion. (Transcript pp. 5-6).

The trial was thus concerned primarily with the "equitable" defenses raised by both answers. In effect, both Overmyer and the receiver relied on the proposition that the profitability of a lease would result in a "windfall" if that lease were terminated and that -- assuming

---

* References to "Transcript" refer to the transcript of the trial on 614's Petition for Termination and Possession, January 23, 1974, which is part of the record on this appeal.

tender by Overmyer of pre-petition arrears -- this factor alone required the Bankruptcy Judge to decline termination. Thus the trial dealt with the issues of profitability and arrearages, although 614 insisted throughout that the unquestionably valid termination and the circumstances of this case required the opposite result. Judge Babitt determined, in the interests of fairness to the receiver and Overmyer, to allow trial of the equitable defenses before making any judgment on the legal issues presented.

On the issue of profitability, Sam H. Flanagan, an employee of the receiver, testified that the gross rental from the three subtenants then occupying Minneapolis #4 was $15,237 per month. (Transcript p. 23). Flanagan testified that based on the payment of rent to 614 of $7,698 per month, and on estimated taxes of $3,252 per month, the premises produced a differential to Overmyer of $4,300 per month -- or $51,600 per year. (Transcript p. 23). Flanagan's tax figure was some $419 per month below what was and has since been actually paid by the receiver -- a fact which both the receiver and Overmyer still have not acknowledged in the schedules appended to their brief. With that modification, and based on full occupancy, the premises

at the time of trial yielded $46,416 per year to Overmyer. That figure, both the debtor and receiver claimed, represented the "windfall" that would become the landlord's in the event of termination.

As it turned out on cross-examination, however, Flanagan's figures were purely gross amounts. As Flanagan himself admitted, his calculations encompassed only the sums reserved under the lease, the taxes, and the rents charged to subtenants. (Transcript p. 37). They did not include maintenance; they did not include insurance; they included no allocation for administrative expenses. (Transcript pp. 34-39, 45-46). These omissions created a serious overstatement of the profit which the debtor received from the premises when it was fully occupied.

On cross-examination Flanagan testified that insurance costs were approximately $150 per month. (Transcript p. 35). Another witness, Murray Guy, testified that maintenance costs were estimated at $.02 per square foot per year, amounting to $2,400 per year or $200 per month for a 120,000 square foot property (Transcript pp. 60, 64), a figure which absorbs an additional $.015 figure that in the past was budgeted for extraordinary maintenance expenses

(Transcript pp. 76-77). And none of these figures included any allocation of the administrative expenses of the entire Overmyer operation that were applicable to the premises. For example, Overmyer was operating Minneapolis #4 without a branch manager. All re-rental, maintenance, legal and other problems were handled not, as before, on-site, but from the main office. Yet no amount was subtracted for these functions.

This deficiency was supplied in a separate hearing -- applicable to all of the pending petitions -- in which it was determined that including these insurance and maintenance costs, an average figure of $20,000 per year for each 120,000 square foot property should be allocated as the cost of running the premises. (Testimony of Receiver as to Allocation of Administrative Expense, April 18, 1974, pp. 82-89).

That figure of $20,000 per year -- which does not include any reserve for vacancies -- must, of course, be subtracted from the gross profits which are attributable to the premises assuming it was fully occupied; and it reduces by nearly 100% the profit figure which Mr. Flanagan's testimony implied would be a "windfall" to petitioner --

and which Overmyer, at least, still inexplicably contends is the appropriate profit measure.*

Just as inexplicable is the manner in which the receiver, in particular, glosses over the existence of pre-petition arrearages in this case. Although 614, in sending its notice of termination, did not rely on rental defaults, the issue of arrears was potentially relevant in light of the theory relied on by Overmyer and the debtor. Assuming the existence of all other conditions for the exercise of equitable discretion -- an assumption 614 contended and Judge Babitt found was not correct -- Overmyer

---

* As of today, the premises yields a total of $12,481 per month in gross rentals which, taking into account the rent to 614, taxes and expenses as detailed above, yields a net loss of $6,656 per year. As of October of this year, the premises will bring in a total of $14,898 per month, leaving a net profit of $22,348 per year. The question of the current status of the premises played a large role in the trial. At the time of trial, a vacancy in one-third of the premises was imminent and in fact, it subsequently occurred. Judge Babitt, as he had requested at trial, was kept notified of all developments. Although the occupancy status changed throughout the period between the trial and the decision, it apparently played no role in Judge Babitt's decision since he assumed -- to the advantage of Overmyer and the receiver -- that each litigated property was operating at a substantial profit.

would still be required to tender all pre-petition arrears to invoke the equity powers of the Court. The receiver simply states in his brief that in "the Minneapolis No. 4 proceeding the Landlord conceded there were no pre-petition defaults with respect to basic rent * * *." (Brief of receiver at p. 37). Only in footnote (d) to Appendix A of his brief does the receiver disclose the nature of the uncontested proof offered at trial on this issue.

Sections 3.02, 502 and 15.08 of the lease provide that costs incurred as a result of non-payment or late payment of rent by the debtor -- including attorneys fees and interest -- are "additional rent" due under the lease. 614's witness, Lowell Noteboom, testified that legal fees and interest in the amount of $7,976.75 were incurred as a result of Overmyer's continuing non-payment and late payment of rent and taxes, actions which forced 614 to local courts in Minnesota on several occasions. That amount is "additional rent" under the lease, and that amount had and has not been tendered or paid. (Transcript pp. 8-16). There was no dispute on the amount owing; indeed counsel for the receiver stipulated to the figure. (Transcript pp. 12-14).

Since Judge Babitt's decision was rendered -- indeed just yesterday -- 614 discovered yet another substantial arrearage. In paying taxes due in October to Hennepin County officials in Minnesota, Overmyer wrote a check for $21,000 for Minneapolis #4 which ten days later was either stopped or was returned for lack of sufficient funds. That additional arrearage will be added to 614's proof of claim and will be the subject of an application by 614 to reopen the proceedings below if such action becomes necessary.

Thus the evidence adduced at trial and on the subsequent hearing on allocation of administrative expenses was two-fold. First the claim of a $51,600 profit on Minneapolis #4 was grossly exaggerated. That figure, because of the incorrect tax amount used in the computation, does not even accurately reflect the gross profit, as the receiver claims. And clearly, despite Overmyer's rather ludicrous argument to the contrary, it cannot, as a gross figure, accurately reflect the profitability of the lease, since it takes no account of the expenses Overmyer is obligated to make under the lease itself, expenses which were proved at trial. With those expenses the lease -- assuming full occupancy at the same rentals as were paid at the time of trial -- produces a profit of approximately one-

half that claimed by both the receiver and Overmyer at trial.

Secondly the evidence at trial showed clearly that pre-petition arrears of close to $8,000 had been neither paid nor tendered to 614.

The plan and the arrangement proceeding

Though no attempt will be made here to detail all of the events that have transpired since the filing of Overmyer's petitions in November of 1973, certain key facts, recognized as such by Judge Babitt, are important to a proper understanding of the context in which this case comes before the Court.

614 initiated its petition for termination and possession in early December of last year, some two weeks after the filing of the Chapter XI petitions. Far from "prejudging" the case, as Overmyer charges, and despite the fact that trial of 614's petition took place in January, Judge Babitt awarded termination and possession to 614 only after the passage of some eight months, during which time he kept Overmyer in possession. Even today, because of a stay order entered by Judge Babitt, Overmyer still retains possession.

Throughout this period Overmyer was

responsible for payment of taxes and payment of "use and occupancy" on the premises; and it was and still is responsible for properly maintaining the property. With each passing month, use and occupancy payments have come later and later; maintenance has been virtually non-existent. Thus, in mid-September, Overmyer has still not paid use and occupancy for July; yet 614 must meet its mortgage obligations from its own funds though the lease clearly contemplates that 614 will pay the mortgage from the rentals paid to it by Overmyer. And despite repeated requests for necessary maintenance -- including a request that a zoning violation be corrected -- Overmyer has done nothing.

Also relevant here is the plan of arrangement proposed by Overmyer. That plan, filed in early January 1974, divides landlord creditors into two classes. Those landlords whose property Overmyer wishes to retain are supposedly to be paid 100% of all pre-petition arrears upon confirmation -- although it is difficult to imagine how organizations that are three and one-half months in arrears in use and occupancy payments can hope to meet such obligations. Those landlords whose leases were rejected -- many

of whom, including 614, are the same landlords with litigated properties -- are to be paid their pre-petition arrears by non-interest payments of 1% of the debt every two months, or 6% per year, which means they are to be paid out in 16 years and 8 months! Only in that context can both the unrealistic nature of the plan and the most improbable prospect for confirmation by these creditors be properly viewed.

The opinion of the court below

Judge Babitt rendered one opinion on all of the litigated properties on July 23, 1974. Judge Babitt found -- as 614 had urged from the start -- "that the issues raised here are primarily legal ones on the totality of the evidence adduced at the trial" (Opinion p. 14). Nevertheless, he made fact findings in these cases -- as a whole -- and did so in a manner which cast the contentions Overmyer and the receiver had advanced in the most favorable light.

Judge Babitt found, and assumed in rendering his decision, that with respect to all of the litigated properties "the sublease operations * * * yield a substantial profit"

(Opinion p. 14) -- despite the fact that both the definition of "substantial" and the very question of profitability had been hotly contested in some of the proceedings. The challenge made by Overmyer and the receiver to Judge Babitt's manner of finding facts as a whole does not extend, of course, to this finding since it is a favorable one for them. Rather, it is directed at Judge Babitt's finding that substantial arrears were owed to the landlords of these properties (Opinion p. 9), a finding, of course, which was indisputably correct, at least with respect to 614 and most every other proceeding.

More to the point, Judge Babitt's fact finding process was entirely consistent with what Overmyer itself admitted was its modus operandi. Despite its contention that its subsidiaries are completely separate, Overmyer "sought" -- and still seeks -- "to alleviate cash flow shortages on financially pressed warehouses by utilizing income generated from profitable leased warehouses" (Brief of Overmyer p. 1). In any event, as Judge Babitt certainly recognized, the question of arrears, under the theory advanced by Overmyer and the receiver, comes into play only where other equitable considerations exist first.

Judge Babitt held that the lease provisions involved here were clear and unequivocal and that they were express covenants within the meaning of section 70(b) of the Bankruptcy Act (11 U.S.C. § 110b). Judge Babitt held that pursuant to that section these provisions were clearly enforceable in Chapter XI proceedings. Finally, Judge Babitt held that under the facts and circumstances of this case the equitable considerations -- considerations addressed to the equitable discretionary powers of the trial judge and considerations which might in other circumstances justify a refusal to allow termination -- were simply not present here.*

We show in this memorandum that Judge Babitt's view of the law and the facts of this case is unassailable: we show that in the facts and circumstances of this case there are no compelling equitable or policy considerations justifying a departure from the long-followed rule in this

---

* The receiver contends that Judge Babitt was somehow internally inconsistent in finding for the landlord because at some earlier point he found against the landlord in a proceeding involving Tampa #3. A careful reading of the transcript attached as Appendix B to the receiver's brief, however, clearly reveals that Judge Babitt, there, decided only the issue of possession and not of termination.

Circuit enforcing provisions such as those present here, and that, to the contrary, the equities here dictate their enforcement. The only issue really involved here is whether Judge Babitt, recognizing the equitable powers which he had, abused his discretion by enforcing the termination provisions of the lease; we show that he clearly has not done so here.

Argument

THE COURT BELOW PROPERLY EXERCISED ITS EQUITABLE DISCRETION IN FINDING THAT NO CIRCUMSTANCES EXIST HERE TO JUSTIFY NULLIFICATION OF A TERMINATION DULY EFFECTED UNDER AN UNQUALIFIED CLAUSE MAKING THE FILING OF A CHAPTER XI PROCEEDING A DEFAULT WHICH MAY NOT BE CURED.

Where a lease provides that it may be terminated at a landlord's election if a tenant files a Chapter XI proceeding,where that lease contains no provision either qualifying such a clause or providing a method for curing that default and where a bankruptcy judge has properly found no compelling equitable considerations which dictate otherwise, the terms to which commercially knowledgeable parties have agreed should not and may not be nullified.

The principle that a termination clause -- predicated on the filing of a petition under the Bankruptcy Act -- is valid and enforceable was determined almost 30 years ago by the Supreme Court of the United States. In Finn v. Meighan, 325 U.S. 300, 301 (1945), the Court -- in very plain and unqualified language -- held that "an express covenant of forfeiture has long been held to be enforceable against the bankruptcy trustee." That holding has been followed time and time again. See, e.g., Schokbeton Industries, Inc. v. Schokbeton Products Corp., 466 F.2d 171, 175 (5th Cir. 1972); Robinson v. Hadley, 351 F.2d 385, 387 (9th Cir. 1965); In re Technical Marine Maintenance Co., 169 F.2d 548, 551 (3d Cir. 1948); Urban Properties Corp. v. Benson, Inc., 116 F.2d 321 (9th Cir. 1940). Significantly, this Circuit and this District, in particular, have never deviated from what the Supreme Court has held was a required construction of the clear language of § 70b of the Bankruptcy Act, 11 U.S. § 110(b) (Supp. 1973). See, e.g., Speare v. Consolidated Assets Corp., 360 F.2d 882, 886 (2d Cir. 1966); B. J. M. Realty Corp. v. Ruggieri, 326 F.2d 281, 282 (2d Cir. 1964); Oldden v. Tonto Realty Corp., 143 F.2d 916 (2d Cir. 1944); In re Wise Shoe Co., Inc.,

26 F. Supp. 762, 764 (S.D.N.Y. 1939).

Overmyer and the receiver did not below, and despite what appears to be a weak argument by Overmyer, cannot seriously quarrel here, with the validity of this proposition, a proposition which Judge Babitt correctly stated was "foreclosed as a litigable issue." Neither are they contending that the termination clause at issue here is anything but the "express covenant" referred to in Finn v. Meighan, supra and in section 70(b). Instead they argue that because they reap a profit from the operation of the premises when it is fully occupied, enforcement of the termination clause -- though concededly enforceable in Chapter XI proceedings -- should be denied to 614. This result, they claim, is dictated by several cases, most notably Smith v. Hoboken R. R., Warehouse & S. S. Connecting Co., 328 U.S. 123 (1946); Weaver v. Hutson, 459 F.2d 741 (4th Cir.), cert. denied, 409 U.S. 957 (1972); In re Fleetwood Motel Corp., 335 F.2d 857 (3d Cir. 1964); and Queens Boulevard Wine & Liquor Corp. v. Blum, F.2d (Docket No. 73-1512, June 11, 1974). These cases, contend Overmyer and the receiver, stand for the broad proposition that where termination of

a lease would result in deprivation of profits to a debtor, termination must be denied despite the existence of an express provision to the contrary agreed to by commercially knowledgeable parties. In fact, however, no such principle exists. These cases, far from being mandatory, carve out limited exceptions addressed to equitable considerations -- considerations which the Bankruptcy Judge, in the exercise of his discretion, properly found not to exist here.

In Smith v. Hoboken R.R., supra, the Court held that the overriding public interest in the continued operation of a railroad required a finding by the Interstate Commerce Commission that termination was consistent with reorganization before a 99-year lease of a major portion of the railroad's right of way could be terminated. In In re Fleetwood Motel Corp., supra, the Court held that it would not enforce a termination clause in a 99-year lease where -- in the context of Chapter X proceedings -- the Securities and Exchange Commission had shown that a public investment of over one-half million dollars would be lost and the debtor would be deprived of its only asset. Similarly, in Weaver, the Court found that forfeiture would have provided the landlord with a windfall of approximately

one million dollars; but most significantly, the Court again placed principal emphasis on the position taken by the Securities and Exchange Commission that -- in the context of the Chapter X proceeding involved there -- the debtor's entire estate would be wiped out, resulting in a total loss to the debtor's public stockholders and debenture holders. Obviously the considerations present in Chapter X proceedings or in railroad reorganization proceedings -- in short an overriding public interest factor --have no bearing where, as here, no public investment or no common carrier is involved.

In the final analysis then, Overmyer and the receiver must place their principal emphasis on the Queens Boulevard case, recently decided by this Circuit. In that case the Court of Appeals, with one member of the panel dissenting,found that "a lease termination provision [is] unenforceable when compelling equitable and policy considerations so require * * *." (Slip Op. at 4120). The argument of Overmyer and the receiver thus boils down to the proposition that the "compelling" considerations present in Queens Boulevard are present here; and it is on that contention that their entire argument must fall.

Briefly the facts in Queens Boulevard were these. The debtor was a single-location liquor business. The lease for its store contained a bankruptcy termination clause; but in addition it contained a clause permitting the default occasioned by the filing of bankruptcy to be cured by tender of arrears. Furthermore, the lease provided that the landlord, at its option, could apply all or part of the tenant's $8,000 security deposit against rent due.

The debtor filed a Chapter XI petition and, pursuant to a court order, continued to pay its landlord use and occupancy. One month after the filing of the petition, the landlord sought to regain possession of the premises. Some three weeks later, the debtor tendered to the landlord a certified check for the full amount of arrears due; that tender was rejected.

By the time the landlord's petition was heard the plan of arrangement was on the verge of confirmation; only the landlord's petition to regain possession of the sole premises of the debtor stood in the way. Indeed, the debtor had been operating at a profit; it had continued timely payments to the landlord for use and occupancy; and it had paid to the trustee more than $50,000 to be applied

toward payment of its debts if the plan of arrangement was accepted and confirmed.

In light of these circumstances the Court held that the termination clause in the lease should not be enforced. To insure, however, that its holding would in no way be interpreted as "inconsistent with those cases which have upheld a termination clause such as that in the instant case" (Slip Op. p. 4122) the Court stated explicitly what moved it to require the exercise of its discretionary equity powers. First, termination, the Court found, would have totally frustrated an arrangement by depriving the debtor of an asset absolutely necessary to its continued viability -- specifically its sole location. Second, relief from termination caused no harm whatsoever to the landlord, which had been timely paid its use and occupancy, which had rejected full tender of arrears despite the curing provision of the lease, and which had in its possession a substantial security deposit to protect itself. Finally, the debtor had apparently succeeded in rehabilitating itself, and its plan was on the verge of confirmation, prevented only by the refusal of its landlord to insure a continued place of business. These were the factors which the Court held were

the "compelling equitable and policy considerations" justifying non-enforcement of a lease termination provision. None of them are present here.

Unlike the debtor in Queens Boulevard, and as Judge Babitt noted, Overmyer is not a single-location business. This lease is a commodity to Overmyer -- just as contracts for the sale of goods are commodities for other businesses. Not only is this lease not Overmyer's sole asset but it is for a building not even occupied by it. Simply put, the lease involved here is simply not on the same footing as that involved in Queens Boulevard.

Perhaps most significant here is the injury that has been caused to 614, and undoubtedly to many other landlords, as contrated with the landlord in Queens Boulevard, which suffered "no harm whatsoever". (Slip Op. at 4123). Unlike the landlord in Queens Boulevard, 614 is not protected by a security deposit. Unlike the landlord in Queens Boulevard, no tender has been made to 614 of any arrearages. Unlike the landlord in Queens Boulevard, use and occupancy payments have not been timely made, but have been progressively later to the point where today July use and occupancy and July taxes have still not been paid. Since the filing

of the Chapter XI petition 614 has been forced to reach into its own funds to keep current its mortgage and tax payments,although the lease clearly provides that Overmyer is to pay the taxes and although it clearly contemplates that the mortgage is to be paid from the lease rentals. Similarly, Overmyer has ignored its maintenance obligations. It has done nothing since the filing of the Chapter XI petitions despite the fact that it has been notified of a dire need for repairs, including the correction of a zoning violation.

Finally, unlike the plan of arrangement in Queens Boulevard, the plan here is nowhere near acceptance or confirmation. As Judge Babitt -- who has the ultimate responsibility for confirmation -- noted, the plan "carries pie-in-the-sky elements." Its proposal for a pay-out of landlords with rejected leases over nearly 17 years is untenable; and its proposal for immediate pay-out of landlords with litigaged properties is unrealistic. In short, the optimism of Overmyer and the receiver simply ignores the fact that the plan must be approved by the landlord classes of creditors -- most of whom want nothing more than the rightful return of their properties with the con-

commitant ability to insure full future utilization, to enable timely payment of mortgage obligations and to effect proper maintenance and repairs.

The equities in favor of Overmyer and the receiver thus are far from compelling; indeed, they are non-existent. Only a contention that mere profitability of a lease, with nothing more, requires termination under a "windfall" theory could overcome the conclusion that fact requires. Even were that theory correct, the amounts involved here -- approximately $1,800 per month on the Minneapolis #4 lease -- would not justify the exercise of any such power. In any event, that is clearly not the law. Except in circumstances where "compelling equitable and policy considerations" dictate otherwise -- considerations within the province of the Bankruptcy Judge's equitable discretion -- the bargain made between commercially knowledgeable parties should be enforced. In finding that those compelling considerations did not exist here, Judge Babitt clearly acted well within the limits of his equitable discretionary authority.

Conclusion

For all of the foregoing reasons petitioner-appellee, The 614 Company, respectfully requests that the order and judgment appealed from be affirmed.

Nickerson, Kramer, Lowenstein,
Nessen, Kamin & Soll
Attorneys for Petitioner
919 Third Avenue
New York, New York 10022
(212) 688-1100

Harold P. Weinberger, Esq.
Of Counsel

Copy Received
Bruchs Lupton & Lupton
11/12/24

COPY RECEIVED
LEVY, LEVY & RUBACK

ATTYS. FOR Debtors - Appellants

DATE November 12, 1924